

STATE OF DELAWARE
OFFICE OF
AUDITOR OF ACCOUNTS

APPOQUINIMINK SCHOOL
DISTRICT

TUITION TAX
PERFORMANCE AUDIT

FISCAL YEAR 2007

FIELDWORK END DATE: NOVEMBER 15, 2007

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EXECUTIVE SUMMARY

BACKGROUND

Title 14, Delaware Code, *Education*, Chapter 6, *Tuition Charges*, authorizes local school districts to levy a tax on district residents to pay for tuition eligible programs administered by the districts and private institutions. This tax is not subject to voter referendum. Delaware Department of Education (DOE) approves the educational programs that are tuition eligible and the tuition tax bills between the districts and provides regulations on allowable expenditures and the types of special needs that are funded by tuition eligible programs. The school district may educate the special needs child within the district or, if the child's needs require, may send the child to another local school district or private placement.

Appoquinimink School District Tuition Program

DOE has formally approved three tuition eligible programs for Fiscal Year 2007 at Appoquinimink School District (the District). Schools throughout the District may be operating one, all, or none of the tuition programs. There are no students from other districts that participate in the Appoquinimink School District tuition programs.

Appoquinimink School District participated in the DOE Special Education Funding Pilot Program for its first year during Fiscal Year 2007. The intent of the Pilot Program is to make individual decisions based on student need rather than disability category. This increases the opportunity to consider the regular classroom an option for providing special education services when appropriate. In moving toward the needs-based funding system, most students are no longer enrolled in a specific school identified as an Intensive Learning Center. Students are enrolled in their home schools and provided with an intensive or complex level of special education services under the Special Education Funding Pilot Program. As a result, additional resources (e.g., special education teacher, paraprofessionals, etc.) are provided in the regular education classrooms. This blending of regular and special education students in the classroom has made it more difficult to specifically identify authorized positions and their funding sources to tuition eligible programs. The August 29, 2006, Pilot Program memo, under the requirements for Intense and Complex Special Education Units, states "Each district would have the ability to generate tuition to cover the local cost of the educational program for these students and any excess costs involved in the provision of FAPE (Free Appropriate Public Education) to these students." Per the DOE memo, students in the Intense and Complex grouping are tuition tax eligible.

The District spent approximately \$4,300,000 on its tuition program during the fiscal year ended June 30, 2007.

AUDIT CONCLUSIONS AND OBSERVATIONS

Based on the results of the audit procedures performed, Office of Auditor of Accounts (AOA) noted instances where the District charged expenditures to the tuition tax program that were not allowable. The District's tuition tax budget was developed based on allowable educational related expenses.

It was also determined that the tuition tax rate was based on a tuition tax levy budget for which the assumptions were not adequately supported. Tuition tax is one of two types of tax that are not required to pass local referendum prior to changing. The School Board can approve an increase to the tuition tax rate and match tax rate without approval from DOE or the taxpayers. AOA proposes that DOE develop a

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requirement for an independent review of all school districts' tuition tax budgets and provide certification to the accuracy of that budget prior to the School Board approving an increase in the tuition tax rate.

In addition, the District did not correctly complete its tuition tax bills, as AOA noted that the District used the incorrect indirect cost rate in preparing its bills for FY07.

The following findings related to the tuition tax program were identified:

- Of the 59 transactions tested, totaling \$1,975,008, that included 26 payment vouchers (PV), 23 expenditure corrections (EX), 4 cash adjustments (CA) and 6 intergovernmental vouchers (IV), 19, or \$356,597 of the charges were not readily identifiable as supporting approved tuition tax programs. Of the 80 personnel transactions selected totaling \$114,000 in tuition tax funding, 23, or \$19,314 of the charges were not readily identifiable as working in a tuition eligible program.
- The District has not implemented or documented a methodology for charging expenditures and allocating tuition tax funding units by building earned to the tuition tax program under the pilot program. The District also could not provide adequate documentation detailing how the tuition tax funding units were allocated by building. Therefore, AOA could not verify that 100 percent of Intensive and Complex tuition tax funded units were allocated to the school buildings that generated them.
- The assumptions the District used in developing the FY08 budget that determined a tuition tax rate increase of \$.04 were not adequately supported.
- The District did not properly complete their FY07 tuition tax bills. The District used an indirect cost rate of 8 percent instead of the DOE approved rate of 6.43 percent for FY07.

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AUDIT AUTHORITY

Title 29, Del. C. c. 29 authorizes the Auditor of Accounts to perform post audits of all the financial transactions of all State agencies. The law requires that the audits be made in conformity with generally accepted auditing principles and practices. Such principles and practices are established by two standard setting bodies: the American Institute of Certified Public Accountants, which has issued generally accepted auditing standards, and the U.S. General Accountability Office, which has issued generally accepted government auditing standards.

BACKGROUND

Title 14, Delaware Code, *Education*, Chapter 6, *Tuition Charges*, authorizes local school districts to levy a tax on district residents to pay for tuition eligible programs administered by the districts and private institutions. This tax is not subject to voter referendum. Delaware Department of Education (DOE) approves the educational programs that are tuition eligible and the tuition tax bills between the districts and provides regulations on allowable expenditures and the types of special needs that are funded by tuition eligible programs. The school district may educate the special needs child within the district or, if the child's needs require, may send the child to another local school district or private placement.

Students from the District, other Delaware districts, and other states may attend the tuition eligible schools or programs, provided the students qualify for the service. In determining the tuition to be charged, the District is required by Title 14, Delaware Code, *Education*, Chapter 6, *Tuition Charges* to compute the tuition by adding its share of educational related expenses as allowed by DOE regulations. The sum of the allowable expenses is divided by the total number of pupils in the authorized program and grades and attending all public schools in the receiving district as of September 30 of the current school year to calculate a tuition rate per pupil. The cost for the current year may be estimated cost and shall include an amount, added or subtracted from the estimate, which will represent the difference between the estimated and the actual costs of the tuition charges for the same purpose in the previous year. The District estimates tuition program expenditures based on a tuition tax program budget that it prepares on an annual basis. The budget takes into consideration prior year expenditures, expected increases/decreases in revenues and expenditures, private placement costs, and funds available from the prior year. For each pupil attending a public school of another district as of September 30, the receiving district shall bill the sending district, and the sending district shall pay the tuition charges per pupil on or before January 1 of the fiscal year in which the bill is submitted to the sending district for payment. In the case of pupils attending the public schools of the receiving district for less than a full term, the tuition charge shall be prorated by reference to the period of time during which such pupils actually attended the receiving district's schools, provided that attendance for part of any month shall be counted as a full month of attendance. The District is required to bill each sending district its share of the tuition rate per pupil. DOE has developed a standard tuition billing form for use by the districts. The tuition billing forms are to be approved by the Secretary of Education prior to billing.

DOE has defined direct and indirect costs on its *Department of Education Tuition Billing Form*. Direct costs are defined as local costs that directly support the provision of educational services, and are readily identifiable as supporting the program without requiring the assignment of costs on a pro-rated or formula basis. The only direct costs that may be assigned on a pro-rated basis are instructional personnel who spend a portion of their time providing instructional services to the special program. For those employees that charge their time to this special program, the district is responsible for maintaining appropriate documentation supporting the time charged.

Appoquinimink School District Tuition Program

DOE has formally approved the following three tuition eligible programs for Fiscal Year 2007 at the Appoquinimink School District (the District):

- Intensive Learning Center (ILC)
- Low-Incidence (Developmental Foundations)

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- Gateway to Learning Preschool Program (Developmental Foundations—Preschool)

Schools throughout the District may be operating one, all, or none of the tuition programs. There are no students from other districts that participate in the Appoquinimink School District tuition programs.

Appoquinimink School District participated in the DOE Special Education Funding Pilot Program for its first year during Fiscal Year 2007. The intent of the Pilot Program is to make individual decisions based on student need rather than disability category. This increases the opportunity to consider the regular classroom an option for providing special education services when appropriate. In moving toward the needs-based funding system, most students are no longer enrolled in a specific school identified as an Intensive Learning Center. Students are enrolled in their home schools and provided with an intensive or complex level of special education services under the Special Education Funding Pilot Program. As a result, additional resources (e.g., special education teacher, paraprofessionals, etc.) are provided in the regular education classrooms. This blending of regular and special education students in the classroom has made it more difficult to specifically identify authorized positions and their funding sources to tuition eligible programs. The August 29, 2006, Pilot Program memo, under the requirements for Intense and Complex Special Education Units, states “Each district would have the ability to generate tuition to cover the local cost of the educational program for these students and any excess costs involved in the provision of FAPE (Free Appropriate Public Education) to these students.” Per the DOE memo, students in the Intense and Complex grouping are tuition tax eligible.

The District spent approximately \$4,300,000 on their tuition program during the fiscal year ending June 30, 2007.

OBJECTIVES, SCOPE & METHODOLOGY

OBJECTIVES

1. Determine if the expenditures charged to the tuition tax program are allowable and for DOE approved tuition programs and that the District's tuition tax budget was developed based on allowable educational related expenses.
2. Determine if the tuition tax rate is reasonable compared to tuition tax bills received from other districts and/or allowable expenditures for tuition tax programs.
3. Determine if the District correctly completed tuition tax bills.

SCOPE

The performance audit covers the period of July 1, 2006 through June 30, 2007 (FY07 Bills) and includes a review of 10 percent of the invoices, personnel, journal entries, and transfers charged to tuition programs. In addition, the audit includes a review of FY07 tuition tax billing forms and a review of the FY08 tuition tax budget that supports the FY08 tuition tax rate.

METHODOLOGY

The audit was performed in accordance with *Government Auditing Standards* applicable to performance audits issued by the Comptroller General of the United States.

Audit procedures consisted of the following:

- Reviewed laws and regulations pertaining to tuition tax programs and the processing of transactions.
- Interviewed appropriate officials at the District and DOE.
- Obtained PHRST and DFMS payroll and transaction data.
- Inspected supporting documentation such as vendor invoices, teacher schedules, and rosters.
- Determined if payroll expenditures, vendor invoices, journal entries, and transfers were allowable and in compliance with applicable laws and regulations.
- Reviewed the District's tuition tax budget process.
- Estimated FY08 tuition program expenditures, billings, and tuition tax rate and compared results to the District's tuition tax budget, expected billings, and FY08 tuition tax rate. (The District's budget process for FY08 occurs during FY07).

The criteria used in this performance audit consisted of the following:

- Title 14, Delaware Code, *Education*
- Fiscal Year 2007 Budget Epilogue language
- State of Delaware *Budget and Accounting Manual*
- Department of Education Regulations (Tuition Billing Form Instructions)

CONCLUSIONS

1. Determine if the expenditures charged to the tuition tax program are allowable and for DOE approved tuition programs and that the District's tuition tax budget was developed based on allowable educational related expenses.

Based on the results of the audit procedures performed, AOA noted instances where the District charged expenditures to the tuition tax program that were not allowable. The District's tuition tax budget was developed based on allowable educational related expenses.

Findings related to the objective above were identified at the District level.

2. Determine if the tuition tax rate is reasonable compared to tuition tax bills received from other districts and/or allowable expenditures for tuition tax programs.

Based on the results of the audit procedures performed, it was determined that the tuition tax rate was based on a tuition tax levy budget for which the assumptions were not adequately supported.

Findings related to the objective above were identified at the District level.

3. Determine if the District correctly completed tuition tax bills.

Based on the results of the audit procedures performed, the District did not correctly complete its tuition tax bills.

Findings related to the objective above were identified at the District level.

FINDINGS AND RECOMMENDATIONS

Objective 1

Finding #1 – Tuition Tax Expenditures

AOA reviewed 10 percent of the invoices, journal entries, transfers, and personnel charged to the tuition eligible programs at the district. Of the 59 transactions tested, totaling \$1,975,008, that included 26 payment vouchers (PV), 23 expenditure corrections (EX), 4 cash adjustments (CA), and 6 intergovernmental vouchers (IV), 19, or \$356,597 of the charges were not readily identifiable as supporting approved tuition tax programs. Of the 20 transactions that were not readily identifiable as supporting approved tuition tax programs, 6, or \$10,852 were disallowed and the remaining 14 transactions, or \$347,825 lacked appropriate supporting documentation, and thus, AOA could not determine if the expenditures were allowable. Of the 80 personnel transactions selected totaling \$114,000 in tuition tax funding, 23, or \$19,314 of the charges, were not readily identifiable as working in a tuition eligible program.

Therefore, the District did not properly allocate charges that were for both tuition eligible programs and regular education, and charged expenditures to the tuition tax program that were not allowable and not adequately supported.

Title 14, Delaware, *Education*, Chapter 6, *Tuition Charges*, Section 602(b), states, “in determining the tuition to be charged, the receiving district shall compute the tuition by adding such receiving district’s share of educational expenses as allowed by Department of Education regulations.” DOE regulations detailed on the *Instructions for Department of Education Tuition Billing Form* states, “direct costs are limited to those local costs that directly support the provision of educational services, and are readily identifiable as supporting the program without requiring the assignment of costs on a pro-rated or formula basis. The only direct costs that may be assigned on a pro-rated basis are instructional personnel who spend a portion of their time providing instructional services to the special program. For those employees that charge their time to this special program, the district is responsible for maintaining appropriate documentation supporting the time charged.”

Recommendation

The District reimburse the tuition tax appropriation for the \$30,166 in expenditures that were determined to be unallowable charges. In addition, the District should put policies and procedures in place to ensure that the tuition program is being appropriately charged for allowable costs under DOE approved tuition programs and that these charges are adequately supported.

Auditee Response

The District will reimburse the Tuition Tax fund from Local funds for the unallowable charges. The District will establish an internal procedure to ensure that all costs for tuition programs are adequately supported.

FINDINGS AND RECOMMENDATIONS

Finding #2 – Allocation Methodology for Compliance with DOE Funding Pilot

Appoquinimink School District has not implemented or documented a methodology for charging expenditures and allocating tuition tax funding units by building earned to the tuition tax program under the pilot program. The District also could not provide adequate documentation detailing how the tuition tax funding units were allocated by building. Therefore, AOA could not verify that 100 percent of Intensive and Complex tuition tax funded units were allocated to the school buildings that generated them.

The FY07 Tuition Billing Form and Instructions provided by DOE state, “The only direct costs that may be assigned on a pro-rated basis are instructional personnel who spend a portion of their time providing instructional services to the special program. For those employees that charge their time to this special program, the district is responsible for maintaining appropriate documentation supporting the time charged.”

A DOE Funding Pilot program memorandum, dated August 29, 2006, states “The following requirements are used for the Intensive and Complex Special Education Support Unit of service: 100 percent of the units must support the students that generate them and there is no variance in the use of these units.”

Documentation is an important aspect of control and communication. It generally provides (1) an understanding of an entity’s objectives, (2) a basis for training new personnel, (3) a means of communicating common information, (4) a source of information about accounting controls, and (5) a source of information that will aid in providing continuity in the event experienced personnel leave.

The State of Delaware *Budget and Accounting Manual*, Chapter II states, “A well designed system of controls must include written policies and procedures to ensure that each control objective is met.”

Internal Control - Integrated Framework, published by COSO, defines control activities as policies and procedures that help ensure management directives are carried out. Control activities occur throughout an organization, at all levels and functions, and include a wide range of activities, such as authorizations, verifications, reconciliations, reviews of operating performance, security of assets, and segregation of duties. To ensure control activities meet the objectives of management, written policies and procedures documenting the District’s methodology for charging expenditures and allocating tuition tax funding units to the tuition tax program under the pilot program needs to be established, communicated to employees, and documented.

Due to the lack of having a documented allocation methodology, Appoquinimink School District did not comply with the DOE funding pilot requirement that requires 100 percent of the units that are used for the Intensive and Complex Special Education Support Unit of service support the students that generate the unit.

Documentation of the allocation methodology is important to provide a source of information that will aid in supporting the expenditures charged and allocated to the tuition program.

FINDINGS AND RECOMMENDATIONS

Recommendation

Appoquinimink School District management should develop and implement policies and procedures to ensure compliance with DOE pilot program funding requirements. Included in these policies should be a formally documented methodology to allocate Division 1 Special Education Funding Units to the schools that generate the positions under a needs-based funding system. The District should also formally document its methodology for charging expenditures and allocating tuition tax funding units to tuition tax funds under the pilot program. AOA concurs with DOE's recommendation of utilizing time and effort reporting to support payroll allocations. The documented methodology should be analyzed and reviewed periodically by the District's management and revised as needed.

Auditee Response

The District did not utilize Data Service FTE tracking availability in FY2007. However, the District instituted the use of the staff tracking system by school for FY2008 for Unit Count purposes, thus ensuring that each school received staff support based upon units generated. The District will establish a written procedure formally documenting its methodology to allocate Division I Special Education Funded Units to meet DOE requirement.

Objective 2

Finding #3 – Tuition Tax Rate

AOA reviewed the District's FY08 tuition tax levy budget. The assumptions the District used in developing the budget that determined a tuition tax rate increase of \$.04 were not adequately supported. The District's tuition tax levy budget estimated revenues and expenditures for different period end dates than what is required and also significantly underestimated revenues.

AOA developed an annual FY08 tuition tax levy budget based on prior year expenditures, expected increases/decreases, private placement costs, and funds available from the prior year. The funds available as of June 30, 2007, were \$276,105. Based on assessment of these factors, AOA estimated a June 30, 2008, surplus balance of \$1,800,000 while the District's tuition tax levy budget estimated a deficit balance of approximately \$1,220,000.

The District levies and collects a tax to provide funding for District's pupils enrolled in tuition programs administered by the district, other districts and private institutions. The District should estimate the amount of tuition costs based on known enrollment in tuition programs. The District should estimate tuition program expenditures based on a tuition tax levy budget prepared on an annual basis. The budget should take into consideration prior year expenditures, expected increases/decreases, private placement costs, and funds available from the prior year.

DOE regulations regarding carryover balances detailed on the *Instructions for Department of Education Tuition Billing Form* states, "For districts operating special programs, the maximum carryover balance shall be based upon a reasonableness test that will allow a district to maintain a June 30 balance that allows for contractual encumbrances to be processed for the entire fiscal year, and also allows projected

FINDINGS AND RECOMMENDATIONS

expenditures to be paid through the month of December. There shall be no specific carryover balance limitation for those accounts that are used to pay tuition expenses to other districts. These accounts shall be subject to audit, and the auditors will evaluate the appropriateness of these balances based upon a reasonableness test that they determine for that account.

The District's management did not prepare a comprehensive FY08 tuition tax levy budget for the School Board's review to be used in determining an increase in the tuition tax rate. The District's tuition tax rate may be higher than is necessary.

Recommendation

The District develop an annual FY09 tuition tax levy budget based on prior year expenditures, expected increases/decreases, private placement costs, and funds available from the prior year. The assumptions the District uses in developing the annual budget must be adequately supported, including analysis and forecasting of annual expenditures as well as an accurate estimate of tuition tax revenue based on assessed value.

Auditee Response

The District already has an established budget for tuition tax support programs. The District analyzed the FY2007 expenditures in establishing its FY2008 tax rate in support of its Tuition eligible programs. The District has established a 5-year projected tax rate spreadsheet utilizing assumptions regarding expenditures from private placement, salary/OEC costs, and operational costs. The District is currently utilizing the Data Service Financial module to capture all expenditures charged to the Tuition Tax appropriation.

Auditor's Comment

In response to our audit the District prepared a 5-year projected tax rate spreadsheet. The assumptions the District used in developing the budget that supported the FY08 tax rate were not adequately supported.

Objective 3

Finding #4 – Indirect Cost Rate on Tuition Tax Bills

Appoquinimink School District did not properly complete their FY07 tuition tax bills. The District did not use their DOE approved indirect cost rate for FY07. The District used an indirect cost rate of 8 percent instead of the DOE approved rate of 6.43 percent for FY07.

The DOE memorandum, "LEA Approved Indirect Cost Rate (%) Fiscal Year 2008" states the District's approved indirect cost rate for FY07 was 6.43 percent of directly billed costs.

Due to lack of management oversight, the District used the FY06 indirect cost rate. The use of this rate had no impact on other districts since there were no students from other districts that participated in the Appoquinimink School District tuition programs in FY07.

FINDINGS AND RECOMMENDATIONS

Recommendation

The District use the DOE approved indirect cost rate in order to correctly complete their tuition tax bills.

Auditee Response

The District has addressed this issue in FY2008 by revising the Tuition Tax billing and correctly utilizing the revised Indirect Cost Rate of 6.43% for FY2007 on the FY2008 forms. The District will ensure the utilization of the correct Indirect Cost Rate on all Tuition Tax billings in the future.

DISTRIBUTION OF REPORT

Copies of this report have been distributed to the following public officials:

Executive

The Honorable Ruth Ann Minner, Governor, State of Delaware
The Honorable Richard S. Cordrey, Secretary, Department of Finance
The Honorable Jennifer W. Davis, Director, Office of Management and Budget
The Honorable Valerie Woodruff, Secretary, Department of Education
Ms. Trisha Neely, Director, Division of Accounting, Department of Finance

Legislative

The Honorable Russell T. Larson, Controller General, Office of Controller General

Other Elective Offices

The Honorable Joseph R. Biden, Attorney General, Office of the Attorney General

Other

Ms. Dorcell Spence, Associate Secretary, Finance and Administrative Services, Department of Education
Mr. Jerry Gallagher, Director, Financial Management, Department of Education
Mrs. Joanne Christian, President, Board of Education, Appoquinimink School Board
Dr. Tony J. Marchio, Superintendent, Appoquinimink School District